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ABSTRACT

Recent legal action and research raise doubts about the advisability of measuring fiscal effort in the Illinois general grant-in-aid program by using the simple school district tax rate for operational purposes. Various logical, and perhaps legal, considerations might be sufficient to compel adjustment of the measurement of effort. Beyond these reasons, indications are that in the long run, greater state aid will go to districts that pass tax referenda and retain higher tax rates. The weight of research evidence suggests that low-income school districts will not be able to pass school tax referenda as often and therefore will not be able to take advantage of Illinois' "reward for effort" grant-in-aid system. An income factor is needed in the Illinois formula, more as a correction factor in the measurement of fiscal effort, then as an adjustment to "ability to pay." Introducing a new effort specification in the formula will require change in other parameters in that formula, including the guaranteed valuation level. If Illinois wishes to retain its present concept of "equal expenditure for equal effort," there must be a reevaluation of how effort will be measured. (Author/JG)

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THE CONCEPT OF FISCAL EFFORT IN THE ILLINOIS GENERAL PURPOSE EDUCATIONAL GRANT-IN-AID: Some Legal and Measurement Problems

A Policy Paper for the Technical Task Force on School Finance, the Citizens Commission on School Finance, the State Board of Education, and the Illinois School Problems Commission

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The principal reason for this paper was a reading of the plaintiffs' brief in the Board of Education of the City School District of the City of Cincinnati, et. al. vs. Martin W. Essex, et. al.(1) Although neither of the authors of this paper are attorneys, it is apparent even to laymen that the possibility of similar litigation exists in Illinois. Should this action be brought in Illinois it would likely occur under either the "equal protection of the laws" clause of Article One, Section Two, of the Illinois Constitution of 1970, or perhaps under the wording of Article Ten, Section One, e.g., the education article. The secondary reason for this paper was the appearance of new research on the determinants of school district tax rates.(2) Both the legal action and the research have led us to question the advisability of measuring fiscal effort in the Illinois general purpose grant-in-aid by using the simple school district tax rate for operational purposes. The tax rate now seems to us to be an imperfect or partial specification of the concept of "fiscal effort."

To see the possibility of unequal treatment of the law which might occur because of the use of the actual tax rate, consider two taxpayers, A and B. Let us say that both live in unit districts and both have tax rates of $2.90. Under the present school finance arrangements both are guaranteed an expenditure level of $1,260, because both are presumed to have exerted equal "fiscal effort." It should be remembered that "equal expenditure for equal effort" was a hallmark, indeed almost a battle cry, of the forces that brought about the reform of the Illinois grant-in-aid system in the summer of 1973.(3) But does a $2.90 tax rate in one Illinois school district have the same fiscal meaning as

a $2.90 tax rate in another Illinois school district? Does a $2.90 tax rate in both districts really constitute "equal effort?" We think not. Suppose first that the property in citizen A's district is assessed at a lower value than in citizen B's district, and that the recently passed HB 990 does not completely erase these assessment differentials. Suppose secondly that the "property" in citizen A's district is composed more of commercial and industrial valuations, while the "property" in citizen B's district is more residential in nature. Suppose thirdly that the median family income in district A is higher than in district B.

If all three of the above suppositions are true, then citizen B may well have a just complaint that the state school finance law discriminates unfairly against him or her in favor of citizen A. In the first place, A's tax rate of $2.90 should be reduced to the extent that his or her property is assessed at less than the assessment in B's district. Only if all districts in Illinois were assessed at exactly the same assessment rates, 33% or whatever, would the actual tax rates have the same fiscal meaning. In other words HB 990 would have to be carried out to the letter of the law, and that likelihood can at least be questioned. In the second place, if A's property tax base is composed of large amounts of commercial and industrial valuations, there is a strong likelihood that A will be able to "export" much of the school property tax by passing it forward to the clients and customers of the owners of commercial and industrial properties. Since B's valuations are residential in nature, there will be much less possibility of the incidence of this tax being shifted to others. Finally, if B must pay these property taxes out of a lower family income, then the financial effort of B is greater than the financial effort of A, and yet the formula for school support in

Illinois treats A and B as if they had made the same financial effort. This last fact may well affect the outcome of tax referenda. In the language of the Cincinnati complaint: ". . . the burden of such tax upon individual taxpayers within the taxing district varies depending upon the respective abilities of such taxpayers to pay. This circumstance, in turn, affects the willingness and financial ability of residents and voters in the Cincinnati school district and similarly situated school districts to approve property tax millage levies, which, by law, may not be passed without their approval."(4)

The above logical, and perhaps legal, considerations might be sufficient cause in and of themselves to compel adjustment of the measurement of effort in the Illinois formula. However, there is additional light thrown on this situation by some school finance research. It is true that the large increase in state aid in the last four years in Illinois has brought this state closer to such equity goals as: (a) reducing the disparity in expenditure levels between school districts, and (b) making expenditures less dependent upon local wealth (attainment of fiscal neutrality or wealth neutrality). Excluding federal assistance and state categoricals, the research at the Center for the Study of Educational Finance has documented this trend in some detail. (5) However, in the period beyond full funding of the present formula, we are likely to encounter quite a different situation. In the long run, the greater state aid will go to those districts that pass tax referenda and retain the higher tax rates, all other things remaining equal. When we reach full funding, we should remember that some eight years ago Johns and Kimbrough pointed out that in Illinois and Kentucky there was a positive

linear relationship between income and tax effort, e.g., the richer districts exerted the greater effort and the poorer districts exerted the lower effort. (6) In the Center's evaluation of the 1973 formula change, after only one year of experience, the same positive relationship between family income and tax effort was again noted. (7) More recently, Gensemer has demonstrated that in Ohio there is a strong relationship between median family income and educational tax rate. To be specific, Gensemer found that each additional $100 in 1969 median family income was related, on the average, to an additional 0.14 mills on a school district's 1975-76 school operating millage rate. (8) Gensemer's model was multivariate in nature and income was the best predictor of local tax rates. In Illinois, Yang and Chaudhari have also recently shown that low income is associated with medium to low effort, while high income, along with high educational attainment, high occupational status, and high residential housing value are associated with high educational property tax effort. (9) The Yang and Chaudhari data suggests that these relationships are stronger for dual districts (separate elementary and high school districts) than for K-12 districts in Illinois. Although the research relating income to tax effort is not absolutely conclusive, the weight of the evidence suggests that low income school districts will not be able to pass school tax referenda as often and therefore will not be able to take advantage, in the long run, of the state's "reward for effort" grant-in-aid system. Research of a correlational nature cannot, of course, demonstrate "why" this is true. It might be due to a lack of local leadership or salesmanship that could be corrected if the state department took the lead in helping

income poor school districts pass tax referenda. It might also be true, however, that no amount of selling by anyone would overcome the resistence of low income citizens to property tax increases for schools. If this finding holds up, it has consequences for all states which have passed "guaranteed tax yield" or "guaranteed valuation" types of school finance reform, e.g., Michigan, Colorado, Kansas, and New Jersey, as well as Ohio and Illinois. It would also have implications for states such as Missouri, which are now considering "guaranteed tax yield" add-ons to their basic foundation formulas. (10)

We are thus led to the same conclusion that Walter McMahon reached a short time ago in a paper submitted to the Illinois Technical Task Force on School Finance (11), but by a somewhat different process of reasoning. We also believe that an income factor is needed in the Illinois grant-in-aid formula, but we think it is needed more as a correction factor in the measurement of fiscal effort than as an adjustment to "ability to pay." Furthermore, we see the introduction of the income factor as only one part of a larger reform effort to make the concept of "fiscal effort" more realistic and more equitable in the Illinois formula. Regardless of the effects of HB 990, it seems to us that the effort measurements should be based upon full market values of property and not upon assessed values of property. Unless the state is willing to give up all local assessment and go to state-wide assessment, as did the state of Maryland, there will always be variances created by local conditions and local pressures, and the application of the law will therefore always be unequal. Also, since the incidence of the property tax upon commercial and industrial valuations is difficult, if not impossible, to know, the measurement of fiscal effort might

well be based upon residential values alone. These considerations, together with the addition of an income factor, would yield something like the following formulation for "fiscal effort" in the Illinois formula:

$$\text{Fiscal Effort} = \left[\frac{\text{Revenues collected locally}}{\text{Full Market Residential Valuation per TWADA}} \right] \times \left[1 - \frac{\text{District Income TWADA}}{\text{State Income TWADA}} \right]$$

or alternately the second factor could be:

$$\left[\frac{\text{State Ave. Income, TWADA}}{\text{District Income, TWADA}} \right]$$

If we introduce a new effort specification into the grant-in-aid formula, we will have to change other parameters in that formula, including the guaranteed valuation level. The practical objections to the above formulations are that we do not have residential valuations by school districts and also our very old problem in Illinois of not having good annual income data by school district. It is true that very few states can currently provide property valuation data by school district in terms of residential, industrial, commercial, and agricultural classifications. That, however, is no reason not to request such data. In fact, if we had such data, we might well find that we would not need an income factor in the formula since residential valuation and income would probably be closely correlated. Other states do have income data by school district, usually derived from their state income tax forms. Iowa has collected income data for many years and Missouri intends to start collecting these data next year. To overcome the resistance of legislators from income wealthy districts in Illinois to even getting income data, it may be necessary to assure them that an income adjusted

effort factor will only be used to help income poor districts and not to hurt income wealthy districts. In the above formulations the income multipliers can be made effective only at values below the state average income with no penalty to high income districts. We should also explore all possible alternatives to using the state income tax form. It will be argued, with some justification, that census income data is too old to use in the formula, even if updated on a county basis. It will also be argued that placing a line on the income tax form is too expensive, or that taxpayers will not know the school district in which they reside. These arguments are not very persuasive to us, but they apparently are to others. We therefore need to explore other sources of income data. McMahon has suggested exploring township income data used in the federal tax-sharing apparatus. In Ohio it has been suggested that wage data collected for state employment security purposes might also be used for this purpose.

Development of an income adjusted tax effort is already underway in Illinois. Carson and Hou have presented two such models for consideration to the Technical Task Force on School Finance. (12) The Carson-Hou models are somewhat more conservative than the reform suggested above since they attack only the income problem and not the assessment problem or the incidence problem. Nevertheless, their approach is well worth pursuing if only because the price tag on these reforms runs as low as 30 million dollars. Given the state of projected revenues in Illinois, this may well be all that the General Assembly would consider in the immediate future. McMahon and Melton recently developed a geographic cost-of-living index that could also be worked into a revised effort factor in Illinois by adjusting the income factor so that it reflected "real" income

rather than current income.(13) However, to try to correct the effort measurement simultaneously for problems of assessment, incidence, income, and cost-of-living may be more complexity than legislators are willing to buy. If all of these reforms are contemplated, then some attempt must be made to reduce the present complexity before attacking these new problems. The tolerance to complexity may be increasing, however, as more people come to understand that no grant-in-aid formula which takes into consideration the many aspects of the equity problem can ever be very simple in construction.

The major concern of the authors of this paper is with low income school districts. The evidence appears to show that parents in these districts cannot, or will not, vote higher tax rates. We do not believe, however, that the children of families in low income school districts should be penalized for the lack of willingness of their parents or their neighbors to vote adequate school tax rates. After all, children have rights too, including constitutional rights, as well as taxpayers. Some of the problems discussed in this paper might be corrected by giving all districts the power to tax at the maximum which the state will match without referenda. This, however, is not politically likely to occur. The problems might also be made less difficult by lowering further the maximum matching tax rate. However, even if these actions were taken, the constitutional questions concerning the equity of using actual tax rates would remain. We are thus driven to the conclusion that if Illinois wishes to retain its present concept of "equal expenditure for equal effort," there must be a reevaluation of how effort will be measured.

Since the Ohio legislature is currently struggling with these very same problems, every effort should be made to maintain contact with the Education Review Committee of the Ohio General Assembly. The authors would like to express their appreciation to William A. Harrison, Jr., the Staff Director of the Education Review Committee, and to Representative Waldo Bennett Rose of the Ohio GeneralAssembly, for bringing these matters so forcefully to our attention. We would also like to express our appreciation to John J. Callahan and William H. Wilken, Director and Associate Director of the Legislators Education Action Project, National Conference of State Legislatures, for facilitating these most beneficial interstate exchanges of information on school finance problems. The LEAP project, together with the activities of the Education Commission of the States directed by Allen Odden are most valuable clearinghouses for applied as well as theoretical knowledge in school finance. (14)

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